 Dec 82

The Global Impact of Lower Oil Prices

A major oil price decline would redistribute world income in favor of oil importing countries and against oil exporting countries--the reverse of what happened after the big oil price increases of the 1970s. There is also little doubt that it would be on balance an expansionary factor in the world economy, although there would be a potential for serious disruptions as well, especially in the short term.

The expansionary effect of an oil price decline would probably be proportionately smaller than was the depressive effect of the earlier price increases. While it took two or three years for most oil exporting countries to learn how to spend the added revenues ~~for~~ from higher oil prices, they will be forced to curtail their spending almost immediately as their oil revenues fall. Most of these countries are already running current account deficits, their foreign exchange assets are small, a few have incurred substantial debt, and even the wealthy ones, notably Saudi Arabia, almost certainly will not be willing to draw down foreign exchange assets as rapidly as they built them up. Consequently, major cuts in expenditures of oil exporters on imports of goods and services and for foreign aid, will offset a substantial part of the increase in expenditures in importing countries made possible by lower oil prices.

A large oil price fall would be at least a small factor tending to tighten financial markets, also the reverse impact of the oil price increases. On a global scale, this effect is indirect and small and can be swamped by the monetary policies of the major countries. But the impact on particular countries could be severe and highly disruptive, perhaps even more so than when oil prices rose because there are far fewer oil exporting than oil importing countries and the negative impact of an oil price decline is more concentrated than that of an oil price increase. Moreover, this impact comes at a time when several of the oil exporting countries are having great difficulty adding to an already large external debt. Mexico in particular could be forced to default on its debt, which in turn would create severe risks for the stability of the international banking system.

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